National Energy Board | Office national de l'énergie

Reasons for Decision

Maritimes & Northeast Pipeline Management Ltd.

RH-1-2000

August 2000

Tolls

National Energy Board

Office national de l'énergie

ERRATA

File 4200-M124-1
27 September 2000

Please note that the English version of the *National Energy Board's RH-1-2000 Reasons for Decision dated August 2000* together with Order TG-5-2000 attached therein are corrected as follows:

1. Appendix I, page 41, Order TG-5-2000, second paragraph, shall be replaced by the following:

   "**IN THE MATTER OF** an application by Maritimes and Northeast Pipeline Management Ltd. (M&NP) dated 28 February 2000, as amended, for approval of final tolls effective 1 December 1999 pursuant to subsection 19(2) and Part IV of the Act and filed with the National Energy Board (the Board) under File 4200-M124-1."

2. Appendix I, page 41, Order TG-5-2000, fourth paragraph, shall be replaced by the following:

   "**WHEREAS** M&NP, by application dated 28 February 2000, as amended, applied to the Board for an order or orders under subsection 19(2) and Part IV of the Act fixing just and reasonable tolls that M&NP may charge effective 1 December 1999 until 30 September 2000 for transportation that it provides;"

NATIONAL ENERGY BOARD

Michel L. Mantha
Secretary

Canada

National Energy Board

Reasons for Decision

In the Matter of

Maritimes & Northeast Pipeline Management Ltd.

Application dated 28 February 2000, as amended, for Tolls effective 1 December 1999

RH-1-2000

August 2000

© Her Majesty the Queen in Right of Canada as represented by the National Energy Board 2000

Cat. No. NE22-1/2000-6E
ISBN 0-662-29333-9

This report is published separately in both official languages.

Copies are available on request from:
The Publications Office
National Energy Board
444 Seventh Avenue S.W.
Calgary, Alberta, T2P 0X8
E-Mail: orders@neb.gc.ca
Fax: (403) 292-5503
Phone: (403) 299-3562
1-800-899-1265

For pick-up at the NEB office:
Library
Ground Floor

Printed in Canada

© Sa Majesté la Reine du Chef du Canada représentée par l'Office national de l'énergie 2000

N° de cat. NE22-1/2000-6F
ISBN 0-662-85020-3

Ce rapport est publié séparément dans les deux langues officielles.

Exemplaires disponibles sur demande auprès du:
Bureau des publications
Office national de l'énergie
444, Septième Avenue S.-O.
Calgary (Alberta), T2P 0X8
Courrier électronique: orders@neb.gc.ca
Télécopieur: (403) 292-5503
Téléphone: (403) 299-3562
1-800-899-1265

En personne, au bureau de l'Office:
Bibliothèque
Rez-de-chaussée

Imprimé au Canada

100-07469/

Table of Contents

Abbreviations iii

Recital and Appearances iv

1. Introduction 1
1.1 Background 1
1.2 Application 1

2. Revenue Requirement 2

3. Rate Base 3
3.1 Mainline Construction Costs 3
3.1.1 Background 3
3.1.2 Views of the Applicant 8
3.1.3 Views of Intervenors 10
3.2 Allowance for Funds Used During Construction 16

4. Cost of Capital 19
4.1 Debt Financing Costs 19
4.1.1 Net Proceeds Method 19
4.1.2 Completion Guarantee Fee 19
4.1.3 Cost of Interest Rate Risk Management Products 20
4.2 Rate of Return on Rate Base 21

5. Operating Costs 22
5.1 Operating and Maintenance 22
5.2 Code of Conduct 23

6. Deferral Accounts 24
6.1 Billing Disputes/MN365 Demand Determinants 24
6.2 Other Revenues 25
6.3 Legislative and Assessment Changes to Taxes 25
6.4 Litigation, Mediation and Arbitration 26
6.5 Toll Hearing Costs 26
6.6 Interest Expense 27
6.7 Disposition of Account Balances and Carrying Charges 28

7. Tariff Matters 29
7.1 Termination/Extension of Long-term Service Agreements 29
7.2 Fuel Retainage True-up Mechanism 30

8. Provincial Discounts 32
8.1 Commencement Date of Discounts 32
8.2 Applicability to Delivery Points 32

9. Tolls and Tariff Working Group 35

10. Interim and Final Tolls 36

11. Legal Issues 37
11.1 Burden of Proof 37
11.2 RH-1-99 Practice Direction and Where Evidence May Come From 38
11.3 Use of Past Board Decisions 39

12. Disposition 40

List of Tables

2-1 Revenue Requirement for the Test Period ($000s) 2
3-1 Average Rate Base for the Test Period ($000s) 3
4-1 Approved Deemed Average Capital Structure and Rates of Return for the Test Period 21

List of Appendices

I Order TG-5-2000 41
II Joint Position on Tolling and Laterals 43
III List of Issues 44

Abbreviations

AFUDC	allowance for funds used during construction
Board or NEB	National Energy Board
CAPP	Canadian Association of Petroleum Producers
ECPG	East Coast Producer Group
GT&C	General Terms and Conditions
Irving Oil	Irving Oil Limited
Joint Position	Joint Position on Tolling and Laterals
M&NP or Applicant or General Partner	Maritimes & Northeast Pipeline Management Ltd.
MCA	Master Construction Agreement
MOU	Memorandum of Understanding
NEB Act	*National Energy Board Act*
New Brunswick	Province of New Brunswick
NSPD	Nova Scotia Petroleum Directorate
Shell	Shell Canada Limited
St. Clair	St. Clair Pipelines (1996) Ltd.
test period	ten-month period from 1 December 1999 to 30 September 2000
TransCanada	TransCanada PipeLines Limited
TTWG	Tolls and Tariff Working Group
UEI Holdings	UEI Holdings Inc.
U.S.	United States
Westcoast	Westcoast Energy Inc.

Recital and Appearances

IN THE MATTER OF the *National Energy Board Act* (NEB Act) and the Regulations made thereunder;

IN THE MATTER OF an application dated 28 February 2000, as amended, by Maritimes & Northeast Pipeline Management Ltd. on behalf of Maritimes & Northeast Pipeline Limited Partnership for final tolls effective 1 December 1999 pursuant to Part IV of the NEB Act;

AND IN THE MATTER OF the National Energy Board Hearing Order RH-1-2000;

HEARD at Halifax, Nova Scotia on 26, 27, 28, 29, and 30 June 2000 and 4, 5, 6, and 7 July 2000.

BEFORE:

J.-P. Théorêt	Presiding Member
R.J. Harrison	Member
C.L. Dybwad	Member

APPEARANCES:

L.E. Smith, Q.C. N. Gretener	Maritimes & Northeast Pipeline Management Ltd.
N.J. Schultz	Canadian Association of Petroleum Producers
C. Kemm Yates	East Coast Producer Group
R.R. Moore	Imperial Oil Resources
A. Ilnycky	Mobil Oil Canada Properties
R.G. Dingwall	Mosbacher Operating Ltd.
R.M. Perrin	Nova Scotia Resources (Ventures) Limited
D.S. MacDougall	Enbridge Gas New Brunswick Inc.
J.H. Smellie	Irving Oil Limited
M.A. Gelowitz	J.D. Irving, Limited
P.W. Gurnham, Q.C. J.B. MacIsaac	Nova Scotia Power Inc.
A.C. Reid	PanCanadian Petroleum Limited

J.L. Connors, Q.C. B. Cook J. McNeil	Sempra Atlantic Gas Company
D.G. Davies J.P. Jamieson	Shell Canada Limited
M. Imbleau	Société en commandite Gaz Métropolitain
A.L. Hess	WPS Energy Services Inc.
I. Blue, Q.C. A. Hamilton	Province of New Brunswick
H.D. Williamson, Q.C.	Province of Nova Scotia Petroleum Directorate
M. Proud	Province of Prince Edward Island
C. Beauchemin	Board Counsel

Chapter 1

Introduction

1.1 Background

Following the GH-6-96 proceeding, the National Energy Board (NEB or Board) on 17 December 1997 issued Certificate GC-95 to Maritimes & Northeast Pipeline Management Ltd. (M&NP or Applicant or General Partner). Pursuant to that certificate, M&NP constructed and now operates a natural gas pipeline system extending from Goldboro, Nova Scotia, through the Provinces of Nova Scotia and New Brunswick to a point on the international boundary between Canada and the United States of America near St. Stephen, New Brunswick. This system constitutes the M&NP Mainline (the Mainline).

In its GH-6-96 Reasons for Decision, the Board: (i) approved a forward test year cost of service methodology as being appropriate for M&NP; (ii) approved a 25% common equity ratio coupled with a 13% rate of return on common equity for the first five years of its operations; and (iii) directed that M&NP file tolls incorporating the provisions respecting toll design and laterals as contained in the "Joint Position on Tolling and Laterals" (Joint Position) (see Appendix II).

On 17 September 1999, the Board approved M&NP's Gas Transportation Tariff. In granting the approval, the Board noted that parties with unresolved concerns about the tariff may raise them with the Board at any time. On 14 October 1999, the Board issued Order TGI-3-99 setting interim tolls as applied for by M&NP. In its decision on interim tolls, the Board confirmed that all cost estimates and assumptions used in setting M&NP's interim tolls would be subject to a review in a toll proceeding under Part IV of the *National Energy Board Act* (NEB Act). The Board also directed M&NP to file an application for final tolls by 28 February 2000.

1.2 Application

On 28 February 2000, M&NP applied to the Board pursuant to subsection 19(2) and Part IV of the NEB Act for final tolls effective 1 December 1999. M&NP's application covered the ten-month test period from 1 December 1999 to 30 September 2000 (test period).

On 17 March 2000, the Board issued Hearing Order RH-1-2000 setting out Directions on Procedure and a Preliminary List of Issues for a public hearing to commence on 26 June 2000. On 18 April 2000, the Board revised the List of Issues based on comments received from parties and issued a final List of Issues (see Appendix III).

M&NP's initial application included the costs and volumes associated with the Mainline and the Point Tupper Lateral. On 21 June 2000, M&NP amended its application to remove the Point Tupper Lateral costs and volumes when it became doubtful that the lateral would be in service during the test period.

The RH-1-2000 proceeding was held in Halifax, Nova Scotia and lasted nine days, from 26 June 2000 to 7 July 2000.

Chapter 2

Revenue Requirement

The revenue requirement authorized by the Board for the test period is $95.9 million. This amount is estimated by the Board and is subject to final determinations as indicated in Chapter 10. A summary of the approved revenue requirement together with the Board's adjustments is shown in Table 2-1.

Table 2-1
Revenue Requirement for the Test Period
($000)

	Application	NEB Adjustments	Approved by NEB (Estimated)
Transmission Expense	3,455	-	3,455
Administrative and General Expense	2,098	-	2,098
Toll Hearing Costs	750	-	750
NEB Cost Recovery	520	-	520
Return on Rate Base	53,131	(1,773)	51,358
Depreciation Expense	24,734	(400)	24,334
Municipal & Other Taxes	11,682	-	11,682
Income Taxes	1,723	-	1,723
Total Revenue Requirement	**98,093**	**(2,173)**	**95,920**

Chapter 3

Rate Base

A summary of the applied-for rate base and the approved rate base (as estimated by the Board) is shown in Table 3-1. The Board has made adjustments to certain test period rate base items as discussed in this chapter, resulting in an estimated reduction of $11.6 million to the applied-for test period rate base of $728.6 million.

Table 3-1
Average Rate Base for the Test Period
($000s)

	Application	NEB Adjustments	Approved by NEB (Estimated)
Gross Plant	738,073	(11,800)	726,273
Accumulated Depreciation	(12,291)	200	(12,091)
Net Plant	725,782	(11,600)	714,182
Less: Contributions in Aid of Construction	-	-	-
Total Plant	725,782	(11,600)	714,182
Materials and Supplies	41	-	41
Transmission Linepack	3,773	-	3,773
Prepayments and Deposits	(1,003)	-	(1,003)
Total Working Capital	2,811	-	2,811
Less: Deferred Costs	-	-	-
Total Rate Base	**728,593**	**(11,600)**	**716,993**

3.1 Mainline Construction Costs

3.1.1 Background

Clearing of the right of way for the Mainline began in November 1998. The bulk of the construction work began in May 1999 and continued until October 1999, at which time the line was mechanically complete. At the time of filing its application, on 28 February 2000, M&NP had completed all the construction work except for certain cleanup work that it expects to complete in the summer of year 2000. M&NP stated that the Mainline went into service on 1 December 1999 and that gas first flowed to market on 31 December 1999.

To carry out the construction of the Mainline, M&NP entered into several contracts, the most significant of which is the Master Construction Agreement (MCA) dated 10 June 1998. The MCA was negotiated with BFC-Marine, a joint venture between BFC Pipelines, a Division of the Foundation Company of Canada, and Marine Pipeline Construction Limited (1993).

Project management of the construction work involved two subsidiaries of Westcoast Energy Inc. (Westcoast). UEI Holdings Inc. (UEI Holdings) was the project manager, whereas the work was done by employees of St. Clair Pipelines (1996) Ltd. (St. Clair).

Project Cost Estimates

The evolution of the estimated costs was as follows:

GH-6-96, cost estimate	$593.2 million
January 1999, target control cost	$667 million
July 1999, cost estimate	$710 million
November 1999, cost estimate	$744 million
30 September 2000, expected costs	$742.8 million
By December 2000 estimated total costs	$754 million

The GH-6-96 cost estimate, which was expressed in 1996 dollars, was increased by an escalation factor of 12.5% to arrive at the target control cost of $667 million effective 1 January 1999. The escalation factor of 12.5% was based on a number of considerations, including certain utility cost price indices in the United States (U.S.), financial information from M&NP's U.S. partners and the level of information that M&NP had when it filed its application at the time of GH-6-96.

The project cost estimate was subsequently increased to $710 million in July 1999, to reflect costs trending 20% over the GH-6-96 estimate, and to $744 million in November 1999, to reflect costs trending 30% over the GH-6-96 estimate.

In its application, M&NP provided a variance analysis showing that the capital costs for the project, as of 30 September 2000, had increased by $149.6 million over the cost estimates provided at the time of the GH-6-96 application. As explained below, the evidence showed that a particularly significant variance occurred under the MCA with BFC-Marine.

At the time of the hearing, actual costs of the pipeline were estimated at $754 million, based on expected costs of $742.8 million as of 30 September 2000, debt issue costs applicable to the Mainline of approximately $10 million, and forecasted costs from October to December 2000 of approximately $2 million.

Three areas of concern discussed during the hearing were the MCA costs, the governance and compensation structure, and the incentive compensation plan and success bonus. Each of these concerns is discussed below.

Master Construction Agreement

In March 1998, M&NP set an initial target cost estimate for BFC-Marine's role in the project under the MCA of $282 million. It was set based on BFC-Marine's proposal of a first revision to the overall construction plan. Prior to BFC-Marine's involvement, M&NP was considering construction in one summer season through three construction spreads. The revision called for mobilizing two construction spreads in the winter months and redeploying the same two spreads in the summer months. M&NP stated that the revision was based on BFC-Marine's extensive review of the project scope as well as consideration of several factors, including ground and air reconnaissance, review of the draft Environmental Protection Plan, anticipated environmental permit conditions, commitments made during the GH-6-96 proceedings and inflation.

In May 1998, M&NP applied to the Board for approval to undertake winter construction. Subsequent to the filing, the Federal Department of Fisheries and Oceans Maritimes Region voiced its concerns regarding construction in the winter months and suggested that a further detailed review under the *Canadian Environmental Assessment Act* would be necessary. Since the project schedule would not have permitted time for such a review, M&NP decided to abandon plans for winter construction.

M&NP reviewed the scope of work again and developed another construction plan involving four spreads working simultaneously in the summer months only. BFC-Marine's target cost estimate then increased to $316.6 million by 1 January 1999.

As construction proceeded, the MCA target cost of $316.6 million was finally increased by $108 million to $424.8 million. M&NP provided a detailed analysis showing that there were three major contributors to the cost overruns, as follows:

1.	Adverse forest soil and high groundwater table, including associated adverse impact on labour productivity and support costs.	$67.9 million
2.	Additional work associated with watercourse crossings.	$27.5 million
3.	Adverse welding productivity, adverse bend and setup productivity and acid rock mitigation.	$12.6 million
TOTAL		$108.0 million

Regarding forest soil, M&NP stated that BFC-Marine expected to wait days, not weeks, for evaporation effects to dry the soils to a stage where they could be accessed for grubbing and grading. Further, grading needed to be completed to gain access to the edges of watercourses to install the dams, pumps, culverts and stone to prepare proper equipment crossings. Support equipment, fuels and supplies were far behind the front-line grubbing and grading crews, which further limited their daily productivity.

According to M&NP, the groundwater was unpredictably high, causing more length of trench to fill with water than expected. BFC-Marine's high productivity trenchers could not be used and additional hydraulic excavators were rented from outside sources in an attempt to maintain the project on schedule.

M&NP added that the high groundwater table dictated the need for several additional pumping crews and hampered other operations.

Regarding watercourse crossings, M&NP explained that it incurred an additional $9 million for minor watercourse crossings. Approximately $2.7 million was because of the higher number of watercourses and drains that had to be crossed; 335 crossings were initially estimated compared to 568 actually crossed. An additional $6.3 million was due to increased requirements of federal and provincial permits. The remaining $18.5 million was due to other unexpected costs related to water crossings for design work, cleanup, maintenance and trucking, and right-of-way access.

Acid rock costs were particularly questioned during the hearing. The GH-6-96 global project cost estimate reflected direct costs of $513,000 for acid rock, whereas the as-spent costs exceeded $8 million. A number of other cost categories were also affected by acid rock, including approximately $650,000 in geotechnical consultant costs to investigate the condition and to develop a construction response plan.

The cost variance report showed that BFC-Marine had an initial target cost of $6.6 million for its work with acid rock and that the final direct cost under the MCA reached $7.6 million. M&NP explained that the variance resulted from an additional $2.7 million for the final sampling program, less $1.7 million associated with the decreased length of trench with acid rock and revised mitigation requirements.

Governance and Compensation Structure

M&NP explained that the M&NP ownership and compensation structure was set up in a memorandum of understanding (MOU) dated 1 December 1994. The MOU was ratified by four parties, namely Panhandle Eastern Corporation, Westcoast, Mobil Oil Canada Properties and Shell Canada Limited (Shell).

Among other things, the MOU provided that UEI Holdings, an affiliate of Westcoast, would be the project manager and that an Operating and Maintenance (Operating) Agreement would be negotiated with another affiliate of Westcoast, St. Clair. It also provided that the concept and principles of the fees for these services would be negotiated by the parties in future agreements.

Definitive agreements were concluded on 25 July 1996 and included the Unanimous Shareholders' Agreement, the Limited Partnership Agreement and the Operating Agreement. The agreements were negotiated with the signatories to the MOU as well as with two additional parties, Boston Gas and Eastern Enterprises. These two parties, as well as Shell, however, did not ratify the definitive agreements because, according to M&NP, they did not want to become owners of M&NP.

The definitive agreements provided that, for its services, UEI Holdings would receive a monthly management fee from M&NP's Limited Partnership equal to the actual cost of non-salary expenses that it incurred on behalf of the partners, plus 230% of the allocable portion of the actual salary cost of employees who performed work for the partners during the previous month. The MOU also provides for the project manager to receive an annual management fee determined by a formula and a one-time consulting fee for the project determined by another formula.

The monthly management fee of 230% of salaries was payable to UEI Holdings, but for administrative purposes was actually paid to St. Clair. M&NP pointed out that, as part of the fee, the manager had to

absorb significant administrative and overhead costs. The payment also included a profit component to the manager, which amounted to $6.5 million for the years 1996 to 1999 for all work, including work to date on the planned Halifax, Saint John and Point Tupper Laterals. According to M&NP, the portion related to Mainline work would account for 80% of this amount, or approximately $5.2 million.

The annual management fee[1] is calculated according to a formula involving the profitability of both the Canadian and American portions of the pipeline. Essentially, the fee would be paid if the pipeline earnings exceeded the return on equity allowed by the Board on the Canadian portion of the pipeline. The fee is payable at the earliest on the 1 March following the first full calender year following the in-service date of the Canadian portion of the pipeline. Since the pipeline went into service on 1 December 1999, the annual management fee would not be payable until 1 March 2001. As a result, the test period cost of service does not include the fee.

The consulting fee[2] paid to UEI Holdings on 25 February 2000 amounted to $6.6 million and was meant to be a driver to ensure that Westcoast would assign its top people to the project. The goal was to ensure the project's success, as measured by being built on time, at a cost below the 75 cents rate cap specified in the backstop agreement with Mobil, and being built in an environmentally superior and safe manner. The consulting fee involved top management of Westcoast and concerned overall project direction from regulatory and political standpoints. M&NP stated that it did not involve advice on cost estimating.

Incentive compensation plan and Success Bonus

Out of the 230% fee that it received from M&NP, UEI Holdings as project manager decided to pay incentive compensation to St. Clair's employees. Prior to the test period, UEI Holdings paid approximately $270,334, whereas for the test period, it factored an amount of $400,000 on this account.

M&NP explained that incentives would be paid for overall financial performance of Westcoast, for good performance of the project, and for individual performance. Objectives to be attained included safety, environmental superiority, in-service date, communications control, cost control and others. There was a specific incentive objective to have the pipeline go into service prior to the end of 1999.

---

1 The annual management fee is equal to the product of (i) 0.25 times (ii) the amount, if any, by which the aggregate actual earnings before interest and tax of Maritimes-Canada and Maritimes-U.S. during the immediately preceding calendar year exceeded the aggregate target earnings before interest and tax of Maritimes-Canada and Maritimes-U.S. for such year times (iii) the percentage of such aggregate excess earnings before interest and taxes that was attributable to Maritimes-Canada (rather than Maritimes-U.S.). The fee is payable only if the aggregate return on equity of Maritimes-Canada and Maritimes-U.S. for such year and all prior years, exceeds the aggregate return on equity that Maritimes-Canada and Maritimes-U.S. were authorized to earn in such year and all prior years pursuant to their filings with the NEB and FERC. Further, the cumulative sum of the annual management fee payable by Maritimes-Canada and the annual management fee payable by Maritimes-U.S. is limited to an aggregate average annual amount of U.S. $1 million.

2 The consulting fee is payable within 10 days after the In-service Date of the Canadian Pipeline and is equal to the product of (i) 0.00875 times (ii) the actual cost of the Canadian Pipeline times (iii) a multiplier, pursuant to which the consulting fee (a) will be increased if the General Partner achieves certain cost savings or if there are cost savings achieved for reasons within the reasonable control of the General Partner (with the maximum increase of 10% being due if such cost savings are greater than 10%), and (b) will be decreased if the General Partner is responsible for certain cost overruns or if there are cost overruns for reasons within the reasonable control of the General Partner (with the consulting fee being lost entirely if such cost overruns are greater than 10%).

The project manager also paid a one-time success bonus of a total of $1,035,959 to the St. Clair employees who worked on the project. The bonus was put in place by UEI Holdings and was also paid out of the 230% fee that it received for its services. M&NP explained that the bonus was meant to attract people from St. Clair and the Westcoast family of companies to the Maritimes as well as have them continue working on the project to its completion. It was awarded based on certain success factors for the project, including meeting the time commitment required by the producers, safety, environmental responsibility and ability to manage costs.

3.1.2 Views of the Applicant

M&NP submitted that the proper starting point to analyze the prudence of the final incurred costs is not the estimate produced at the time of GH-6-96 but the target control cost of $667 million that was established in the first quarter of 1998 based on the GH-6-96 estimate.

In M&NP's opinion, the GH-6-96 estimate is not proper for comparison purposes because it was expressed in 1996 dollars and was presented on the understanding that a series of factors would influence the final number, including market conditions for pipe and contracting services, which were expected to heat up in 1999, and the availability of more detailed information as designs were finalized. M&NP explained that, at the time of the GH-6-96 proceeding, the estimate was made in 1996 dollars because pipe mills and construction contractors were uncomfortable with forecasting costs in 1999 dollars, due to the significant degree of uncertainty of projecting costs that far into the future.

M&NP stated that the increase in costs from the $667 million target cost to the applied-for amount of $742.8 million is essentially due to two factors: additional work associated with the move to four simultaneous work spreads and adverse soil and water conditions, mainly because of the presence of acid rock and water in the trench.

Regarding acid rock, M&NP submitted that, at the time of GH-6-96, it had done what was practical, which was to commission a study to determine how to deal with it. M&NP had determined that it would not have been practical, either from an investment or from a feasibility point of view, to have conducted the types of investigations which would ultimately have provided more detailed information on which to develop an acid rock mitigation plan. It also stated that there was significant uncertainty about whether the project was going to proceed and therefore M&NP was not prepared to fully investigate the matter at that time.

M&NP conceded that it could have incurred extra costs earlier on in the project to develop a higher level cost estimate. Citing the Board's RH-2-97 Decision, however, M&NP felt that the associated expenditures could have entailed a high risk of disallowance. In that decision, the Board ruled that *"when a project does not proceed, the Board will allow the recovery of costs incurred, particularly those that go beyond preliminary surveys and investigations, only under exceptional circumstances."*

Regarding water and soil conditions, M&NP referred to the unpredictably high groundwater tables that caused more lineal trench to fill with water than expected. Adverse conditions resulted where the use of high productivity trenchers was precluded, additional pumping crews were required and other operations were hampered. It added that the only way to have known about such conditions ahead of time would have been to have opened a trench along the full right of way, which would not have been feasible.

However, M&NP admitted that the trench was open longer than usual and opened over a long distance (up to 153 km at one point) because M&NP had to deal with approximately 90 to 95 km of rock along the right of way. M&NP added that, in those conditions, there is a need to first dig the trench to expose the outcroppings and then bring in blasting crews to remove them. It also added that this condition did not contribute significantly to the amount of water in the trench because the water that was encountered was groundwater and that the trench filled up very quickly with water.

Overall, M&NP believed that it was proactive in controlling its costs by having ordered pipe in a very tight market as soon as the project was certificated. It also brought its contractor on very early in the process, as early as November 1997, and it negotiated an alliance relationship by which the contractor essentially became an extension of M&NP's design team. The MCA allowed for gain and risk sharing based on the agreed-to construction cost estimate, including scope changes, where the profit margin was made to vary from a maximum of 12.5% to a minimum of 5%, depending on the relationship between the final costs and the target cost estimate. By this mechanism, M&NP submitted that BFC-Marine had a strong incentive to minimize costs while building a product that met high safety and quality standards.

M&NP claimed that this arrangement helped optimize the design and detailed route for the project as well as the training of a local labour force. Even though BFC-Marine realized only the minimum profit margin of 5% on this project, M&NP stated that it was confident that costs would have been higher had standard unit price, lump sum or cost-plus type contract been used. M&NP also referred to its controlling costs through audit controls and ensuing corrective actions.

Regarding the compensation paid to UEI Holdings and St. Clair, M&NP submitted that the associated commercial arrangements were agreed to by key shipper and producer interests or, at the very least, that these parties had benchmarked the arrangements against their own experience. It elaborated that the MOU made clear to its signatories that Westcoast affiliates would manage and operate the pipeline and that the parties would eventually negotiate the fees for these services through definitive agreements.

Because the negotiations of the MOU and the definitive agreements included shippers, such as Mobil and Shell for the MOU and Mobil for the definitive agreements, M&NP suggested that all the fees incorporated in the agreements were established at fair market value.

As for the provision of an annual management fee to the project manager, M&NP suggested that both shippers and the company itself would gain if it becomes payable. The shippers would gain through lower tolls as the operator would have been more efficient and effective in the ongoing maintenance and management of the facility, whereas the pipeline would gain through higher profitability.

Concerning the incentive plan and the success bonus, M&NP stated that it is not requesting specific recovery of the costs because they are not paid by M&NP. They are included as part of the overhead charge paid to St. Clair. Nevertheless, M&NP commented that the success bonus was based on target levels that were fair, that the measurement parameters were reasonable and that the level of payments was appropriate.

In conclusion, M&NP claimed that it had discharged its onus to prove that costs incurred were indeed prudent in all circumstances and that no evidence to the contrary was filed by intervenors. In that regard,

M&NP stated that the Board has to decide on the prudence of the applied-for costs, not on the accuracy of the previous estimates.

3.1.3 Views of Intervenors

CAPP

The Canadian Association of Petroleum Producers (CAPP) stated that a pipeline has no incentive to present a realistic estimate at time of Board project approval if the Board routinely approves the estimate unless some aspect of it can be proven unreasonable. CAPP added that the onus is on the pipeline to prove that its costs were prudently incurred. It also submitted that M&NP should be accountable for its GH-6-96 estimate given that it was a "bid quality" estimate.

While sharing the concerns of other intervenors on cost overruns generally, CAPP believed that the original estimate of $513,000 for acid rock in particular was not realistic, given what M&NP learned about the issue from the report dated 1 August 1996 that it commissioned at the time of the GH-6-96 hearing. CAPP submitted that M&NP knew of the requirement for a field drilling program and of the obligation to mitigate any acid rock encountered. It also knew that acid rock could not be used as backfill and that it had to be hauled away to an approved site. CAPP also referred to several other costs associated with acid rock, including the added geotechnical consulting work and adverse impact on productivity and other costs.

While suggesting that the Board disallow a substantial portion of the cost overruns associated with the acid rock issue, CAPP also recognized that the amount to disallow is difficult to determine. Nevertheless, it suggested that a disallowance of $20 million would be reasonable.

Further, CAPP highlighted the fact that in approving the 13% rate of return on equity for M&NP, the Board referred to M&NP being a greenfield pipeline. On this account, CAPP submitted that there has to be some cash value associated with the higher allowed returns.

Regarding affiliate transactions, CAPP stated that separation should be adequate and effective and that fair market value should be the basic principle for valuing affiliate transactions. It elaborated that, where the transaction involves a service or good of going value, it should be transferred at not less than fair market value and where something is obtained from the affiliate it should be obtained at not more than fair market value.

ECPG

The East Coast Producer Group (ECPG) believed that the measure of just and reasonable tolls should not be taken from inter-affiliate agreements and that regulation should be a transparent process.

ECPG questioned how the inclusion of the consulting fee of $6.6 million could give rise to just and reasonable tolls given that, by its formula, it increases if the actual cost of the pipeline increases. It also pointed out that the fee would be lost entirely if cost overruns exceed 10%. It suggested that the total construction cost target was increased only so as to cause the fee to be paid despite a construction overrun of 30%.

ECPG submitted that it is not just and reasonable to condone the payment of a consulting fee when the overruns were in fact very significant. It pointed out that the fee, if approved by the Board, would be in rate base, thus earning a return, and suggested that the Board disallow the consulting fee.

Regarding the charge of 230% of salaries, ECPG submitted that, within the NEB jurisdiction, there are precedents of 165% for Westcoast, the parent of M&NP, and of 0% for Foothills, another Westcoast affiliate. ECPG pointed out that M&NP acknowledged that the 230% charge includes a portion for profit. It suggested that the 230% charge is not reflective of fair market value and that the Board should only allow an appropriate and reasonable overhead charge in the management fees. ECPG believed that the charge should be a maximum of 165%.

ECPG also suggested that M&NP should not be allowed to recover the annual management fee through the tolls because the associated amounts would be in excess of the 13% rate of return on equity allowed at the time of GH-6-96.

Finally, ECPG cautioned the Board against M&NP's suggestion that the fees are reasonable and that they reflect fair market value just because their negotiations took place with affiliates and other parties. Almost $44 million was or will be paid under the Limited Partnership Agreement, the Unanimous Shareholders' Agreement and the Operating and Maintenance Agreement.

ECPG submitted that the Board needs to look closely at the amounts that have been paid by the partnership to affiliates to ensure that those amounts represent fair market value and to ensure that inclusion of those amounts in the tolls will result in tolls that are just and reasonable.

Shell

Shell endorsed ECPG's submission. In final argument, counsel for Shell also stated that Shell did not sign the definitive agreements because they contained terms that Shell could not support.

Province of New Brunswick

The Province of New Brunswick (New Brunswick) submitted that the MCA was really a "cost-plus" type of contract inasmuch as when it was negotiated, M&NP did not request a cost estimate from BFC-Marine but inquired of its expected margin and willingness to share risk. New Brunswick added that, in its opinion, under such circumstances, detailed cost and management controls are required. In reply argument, however, M&NP maintained that the MCA was not a "cost-plus" type of contract because the contractor margin was not fixed at a specific percentage but made to vary depending on the variance between incurred and target costs.

New Brunswick believed that the Board has no detailed information with which it can make a judgment about the prudence of the cost overruns. It stated that M&NP should have exercised close and detailed financial control and management, and the variance analysis submitted during the hearing falls far short of the management tools that such financial and management control required. The wet soil and trench water conditions by themselves cannot be the reasons for M&NP's significant cost variances and the Board should not accept these general explanations in the absence of more convincing, specific evidence.

New Brunswick cited the Board's IPL RH-2-76 Decision as support for its suggestion that, given the soundness of M&NP's costs estimates, the quality of its contractor, and the appropriateness of its construction schedule, its failure to provide more convincing evidence about the reasons for its significant cost overruns in specific terms can only mean that there was a breakdown in project supervision and in M&NP's efforts to control costs. New Brunswick also suggested that M&NP should have managed its costs within the $667 million target cost estimate.

In conclusion, New Brunswick submitted that the full amount of the cost increase between the target cost of $667 million and the as-spent costs should not be allowed in rate base for reasons of cost inefficiencies and lack of cost control. While leaving to the Board to determine the amount of the disallowance, it suggested that, in the spirit of risk sharing, it should be similar to the amount by which BFC-Marine's margin was reduced by operation of the MCA regarding the cost overruns.

It elaborated that, by its own calculations, when BFC-Marine's margin was reduced from 12.5% to 5%, it had lost some $30 million and that the loss had the effect of having BFC-Marine share some of M&NP's risk of cost overruns. Applying similar logic, it suggested that it would be appropriate for M&NP also to share some of the risk of cost overruns rather than shifting it to its contractor and its customers.

New Brunswick also submitted that the 13% rate of return on equity allowed at the time of GH-6-96 was meant to cover all of M&NP's business, financial and regulatory risks, including the risk that cost overruns in total may not be allowed into rate base. In reply argument, however, counsel for M&NP suggested that the 13% allowed rate of return on equity was not meant to cover the risk of capital cost variances but rather to cover the risk of attaching a new gas supply basin and new markets. It also pointed out that BFC-Marine's negative gainshare saved the tollpayers $15 million, not $30 million as suggested by New Brunswick.

Nova Scotia Petroleum Directorate

The Nova Scotia Petroleum Directorate (NSPD) believed that M&NP failed to reasonably anticipate and properly plan for the impact that the high water table and wet soil conditions would have on its construction productivity and resulting costs. As a consequence, in its opinion, the variance between M&NP's 1999 target cost estimate and its to-date costs, which it found is largely accounted for by the adverse water and wet soil conditions, cannot be determined to be reasonable on the evidence in this proceeding. The NSPD submitted that it is up to the Board to assess how much of the variance should be disallowed. It also stated that the 13% rate of return on equity is meant to address some of the unique aspects to the construction of the pipeline.

The NSPD also suggested that M&NP has not discharged its onus to show that it was prudent in incurring costs by referring to the fact that certain shippers with ownership interests agreed with the contracting structure. It also pointed out that there are other stakeholders whose interests were not adequately protected by the small group of parties who participated in the negotiations.

The NSPD concluded that the Board should carefully review each of the several transactions between M&NP and its affiliates where an open bidding process was not the measure of the price paid by M&NP for the goods and services.

Views of the Board

Project Cost Estimate

The Board agrees with M&NP that the Board has to decide on the prudence of the applied-for costs, not on the accuracy of the previous cost estimates. Nevertheless, while recognizing that the cost estimates are subject to amendment, the Board is concerned that applicants should exercise care and attention in developing such estimates - the Board and interested parties rely on them to assess the economics of a project as well as the extent of their support for and, in the case of the Board, its approval of a project.

Prudence in incurring costs is a fundamental principle which the Board considers in arriving at a decision respecting just and reasonable tolls.

The Board must determine that there exists a reasonable need and basis for the utility to commit funds for construction in the circumstances prevailing at the time when the commitment was made. The Board must also satisfy itself that all expenditures made were incurred reasonably, not carelessly or negligently.

In determining the prudence in this case, the Board has considered the cost overruns, the validity and reliability of construction estimates, the degree and competence of project supervision, contractor selection, the propriety of decisions to begin construction on a certain date, the attempt to complete by another date, and M&NP's attempts to control expenditures. Other factors might be relevant depending on the specific facts of another case.

With respect to the GH-6-96 cost estimate of $593 million, while M&NP told the Board that it was of "bid quality" and was carefully determined, the Board believes there were significant weaknesses in the initial costing of certain items. The Board strongly questions the cost estimate in GH-6-96 of $513,000, versus the actual cost of $7.6 million, for the handling of acid rock, given the approach taken by M&NP towards this item, including having investigated the matter immediately by enlisting the help of a consultant, and the information learned at the time from the August 1996 study.

In the opinion of the Board, cost variances for the project were significant, whether measured by reference to the GH-6-96 estimate or the control target cost of $667 million and the expected actual cost of $754 million. The variances are even more significant when considering that these cost estimates incorporated a contingency allowance of approximately $50 million.

The Board notes M&NP's evidence that it put in place several measures that should have been conducive to the containment of costs:

- A consulting fee was put in place to ensure success of the project through assignment of the top managerial talent of Westcoast.

- In the midst of an expected pipeline construction boom in 1999, M&NP acted quickly in November 1997 in securing as its contractor BFC-Marine, a joint

venture between two large and experienced pipeline contractors, and in ratifying a risk-sharing type of contract with BFC-Marine.

The MCA that was ratified with BFC-Marine in June 1998 incorporated cost containment features; among other things, the profit margin was made to vary from 5% to 12.5% depending on the level of cost containment. Further, as M&NP explained, the MCA allowed BFC-Marine to get involved in the project at an early stage so as to allow it to better manage its risk.

- M&NP testified that costs were constantly reviewed, including a line-by-line analysis of the MCA every two weeks with BFC-Marine.

- M&NP ordered pipe in a very tight market as soon as the project was certificated.

- The project manager put in place two plans to ensure performance and success, namely the incentive plan and the success bonus.

At the same time, the Board has concerns with a number of questionable management practices and decisions:

- M&NP did not do a line-by-line analysis of the GH-6-96 cost estimate of $593 million when it determined the project control cost estimate of $667 million. The only change M&NP made to the GH-6-96 cost estimate was to increase its total by an all-inclusive factor of 12.5% for a three-year horizon. This is to be contrasted with the extensive review of the project scope that BFC-Marine did when it started work on the project and which led to a major revision to the overall construction plan and costs.

- M&NP stated, during the hearing, that it did not expect to have to explain line-by-line the variance for each item between the cost estimate submitted at the time of GH-6-96 and the costs as of 30 September 2000. The Board finds this questionable considering the significance of the cost overruns.

  While M&NP stated that the proper reference for cost variances analysis is the control target of $667 million, it failed to include cost variance analyses using that reference in its initial application. The only variance analysis incorporated in the initial filing was rudimentary and of little value.

  During the hearing, significant variance analyses were obtained only through written and oral information requests. Among other things, it took two requests to obtain an acceptable variance analysis between BFC-Marine's control cost target estimate as of 1 January 1999 and the costs as of 30 September 2000 because the first response combined a number of significant cost variances.

  In the Board's view, the latter detailed analysis should have been part of M&NP's initial application filing. Furthermore, the Board is of the view that the analyses that M&NP submitted did not tie together well and had the effect of confusing the evidence and conveying an impression of a lack of effective cost

control. The Board would have thought that the analysis required to respond to certain information requests would have been readily available as one of the tools to control costs.

- M&NP allowed a significant length of pipeline trench to remain open for a considerable length of time so as to be able to deal with the potential presence of rock.

However, based on the totality of the evidence before it, the Board is of the view that M&NP's management practices and decisions met the standard of prudence that is applied by the Board in allowing costs for the purpose of determining just and reasonable tolls. Therefore, the Board is not disallowing construction costs related to these management practices and decisions, other than the specific costs which are explained hereafter.

With respect to the arguments of CAPP and New Brunswick that M&NP's allowed rate of return on equity of 13% is intended to cover capital cost risk, the Board does not agree. The GH-6-96 Decision specifically refers to the risks associated with sourcing gas from new and untested fields, serving an untested market in Canada, and facing competition in the U.S. northeast market. The risk of M&NP not recovering its prudently-incurred capital costs is not mentioned.

Governance and Compensation Structure

The Board is of the view that the significance of the transactions (consulting fee, monthly and annual management fees) between M&NP and its affiliates requires full transparency and detailed disclosure of the value of all current and future transactions. The onus is on the applicant to demonstrate with appropriate evidence and documentation that no undue preference or advantage is given in its transactions in dealing with its affiliates and that every effort was made to obtain the necessary goods and services at least cost. In that regard, the Board notes that, while the definitive agreements, including the level of compensation to be paid, were discussed with some shippers, the only signatories were shareholders of M&NP and its affiliates.

The Board also notes that the consulting fee was meant to be a driver to ensure that Westcoast would assign its top people to the project and meet a number of objectives, one of which was to have the facilities completed at a toll lower than the rate cap of 75 cents per MMBtu mentioned in the backstop agreement with Mobil. The Board is of the view that the primary goal of this agreement should have been to have the pipeline built at a cost under the control target cost of $667 million, not under the rate cap.

While the Board was told that the consulting fee was, for administrative purposes, paid directly to UEI Holdings (not to the General Partner) and that the consulting fee agreement did not provide for advice on cost estimating, the agreement provided that the fee would be increased if there were cost savings achieved for reasons within the reasonable control of the General Partner. Conversely, the fee would be decreased if the General Partner was responsible for certain cost overruns or if there were cost overruns for reasons within the reasonable control of the General Partner.

The terms of the agreement clearly demonstrate that it was the General Partner's responsibility to contain costs. Furthermore, the Limited Partnership Agreement clearly delegates to the General Partner the full and exclusive right, power and authority to manage, control, administer and operate M&NP's business and affairs.

The Board is of the view that the consulting fee did not result in any additional care or supervision over the level of cost control than it was reasonable to expect from the General Partner. Further, the formula for calculating the consulting fee, as summarized in Annex A attached to M&NP's Offering Memorandum, specifically provides for the consulting fee to be lost if cost overruns exceed ten percent. Considering the magnitude of the cost overrun for the project, the Board believes that, in these circumstances, it would not be reasonable to allow the consulting fee to be part of the rate base. The Board has decided to disallow the $6.6 million consulting fee.

Regarding the fee of 230% of salaries (which included a profit component) that was paid to the project manager, the Board notes that no detailed evidence was filed to support the fair market value of the services rendered by UEI Holdings. As a result, the Board is unable to determine that the services rendered by the project manager were provided at fair market value. Furthermore, it is the Board's view that, in the circumstances of this case, the profit paid to affiliates is not appropriate for inclusion in tolls. Therefore, the Board disallows the portion of the cost that was paid as profit.

Consequently, the Board directs M&NP to remove from rate base the portion of the $6.5 million profit associated with the Mainline. According to M&NP, 80% of this amount or approximately $5.2 million is related to the Mainline, the other 20% being related to the laterals, which will be discussed in a future toll hearing. The amount is based on 80% of the income before tax of St. Clair's profit and loss statements for the year 1996 to 1999 for its involvement with M&NP's project.

Finally, regarding the annual management fee, the Board does not accept that the fee is a legitimate cost of providing pipeline service. Under cost of service regulation, costs are recoverable through tolls if they are incurred to provide service to customers, with the inclusion of a reasonable amount for return. Any amount realized in addition to the allowed return is for the account of the utility, as would be any additional expenses associated with earning the extra return. The Board has decided that the annual management fee should not be included in tolls.

In addition, the Board is concerned that M&NP would believe that it needs to pay a fee to ensure the pipeline is operated in an efficient and effective manner.

Decision

The Board has decided that M&NP should reduce its rate base to reflect the above decisions. M&NP is to make precise determinations of each amount and submit those for Board approval as described in Chapter 10. For depreciation purposes, M&NP is to assume that the reduction in rate base will decrease the "Mains" portion of transmission plant. For the test period, the Board has estimated that depreciation expense should be decreased by $0.4 million.

3.2 Allowance for Funds Used During Construction

When calculating the cost of pipeline construction, pipelines are allowed an Allowance for Funds Used During Construction (AFUDC). M&NP has included AFUDC totalling $39.4 million in rate base on account of the Mainline. It has calculated AFUDC based on the actual use of equity and debt funds. From the date of the project's inception in January 1995, until August 1998, all project financing was provided in the form of equity contributions from the partners. M&NP has therefore calculated AFUDC on these funds at the rate of return on equity of 13% approved by the Board in its GH-6-96 Decision. M&NP argued that it was appropriate to use the rate of return on equity until the end of 1997 because debt was not available to the project until the Board released its GH-6-96 Decision in December 1997, approving the pipeline project. No debt was incurred until September 1998.

M&NP calculated its AFUDC using the lesser of cumulative expenditures to-date and actual equity and debt advanced. Due to the time lag between when expenditures are made and invoices are actually paid, total debt and equity was, at times, less than the expenditures to date. It was M&NP's view that the actual costs were prudent and should be allowed by the Board.

On the basis of M&NP's calculations, total Mainline AFUDC charges for debt and equity were as follows:

AFUDC	Equity	$22,625,000
	Debt	$16,817,000

CAPP argued that rate of return on rate base is the appropriate rate for AFUDC. It submitted that this method has been the longstanding practice of the Board. CAPP noted in argument that the owners' contributions do not necessarily reflect equity market financing, but reflect each of the owners' average cost of capital. ECPG associated itself with CAPP's arguments.

New Brunswick recalculated the cost components of AFUDC using the rate of return on rate base. It concluded that, while the total cost of calculating AFUDC using the rate of return on rate base was not significantly different from the total costs calculated by M&NP based on the actual debt and equity used, the interest component was approximately $8.9 million higher.

In reply, M&NP argued that Revenue Canada allows for the deductibility of actual interest costs rather than deemed or notional interest costs and that tax deductions for interest would not change if the rate of return on rate base is used to calculate AFUDC. In both cases, only actual debt costs incurred by M&NP will be used for income tax purposes.

Views of the Board

The Board expects all pipelines under its jurisdiction to structure their affairs and conduct their business in a manner that will result in the lowest reasonable cost to tollpayers. While M&NP argued that debt was not available prior to certification of the pipeline, the Board is of the view that it could have been available if the partners had been willing to lend the funds to the project, or guarantee the debt as they have with the completion guarantee. Characterizing the advance as a loan, rather than equity, would not have significantly changed the risks associated with advancing the funds. The true

cost of equity advances made by the partners is unknown; however, it is reasonable to conclude that the equity funds advanced by the partners were provided at their average cost of capital.

Calculating AFUDC using the rate of return on rate base will result in significant cost of service savings as the interest portion is deductible in calculating the income tax allowance. The potential savings to tollpayers using M&NP's forecast tax rate of 44.4% is estimated to be approximately $3.9 million. M&NP argued that since it uses its Revenue Canada filings as a basis for its tax deductions, it would only be claiming actual interest paid. However, the Board notes that M&NP is operated by a partnership and M&NP does not, in fact pay income taxes; its partners do. The income tax provision included in the cost of service is a notional calculation.

Decision

M&NP is directed to recalculate AFUDC to reflect the capital structure approved in the GH-6-96 Decision on the lesser of actual funds advanced or the cumulative expenditures to date. In calculating the cost of debt, M&NP is to use the actual cost of debt where applicable and the cost calculated in accordance with the terms of its term bank financing for imputed amounts.

Chapter 4

Cost of Capital

4.1 Debt Financing Costs

4.1.1 Net Proceeds Method

M&NP has proposed using the Net Proceeds Method of recording debt issue costs instead of the more traditional method of capitalizing debt issue costs. Under the Net Proceeds Method, debt is recorded at its principal amount net of the debt issue expenses with the effect that debt issue expenses are funded 100% with debt. This results in a slightly higher interest rate but reduces the rate base by the amount of the debt issue expenses.

Under the capitalization method, the debt issue expenses would be added to rate base. In either case, the principal amount of the debt issue costs must be amortized. M&NP asserted that because the cost of debt is lower than the rate of return, tollpayers will benefit by the difference between the two rates times the amount of the debt issue costs. M&NP estimated the annual cost savings at approximately $100,000. M&NP noted that the Board has approved the use of this methodology in the past for Westcoast.

ECPG argued that the capitalization method results in a lower cost and provided an example during the hearing which assumed that debt issue expenses would be amortized over 25 years. M&NP responded that the apparent cost savings were due to the use of different amortization rates.

Views of the Board

Debt issue costs should be amortized over the term of the debt. When the same amortization period is utilized, the net proceeds method yields a lower cost than the capitalization method.

Decision

The Board finds M&NP's use of the net proceeds method of accounting for debt issue costs to be acceptable.

4.1.2 Completion Guarantee Fee

M&NP is currently paying a guarantee fee of 25 basis points to its partners on the Mainline debt. The fee became effective 30 June 1999 upon the closing of M&NP's Mainline financing and is currently being accrued at $120,000 per month. The fees will cease when the Mainline and the Point Tupper Lateral are completed. M&NP argued that total debt costs would have been higher if the construction financing had been financed on a non-recourse basis. It also noted that the fees are partially offset by a 12.5 basis point reduction in the margin paid on its bank loan.

New Brunswick submitted that the partners of M&NP should not receive this additional return for merely accepting a business risk. It suggested that business risks were considered when it was determined that a 13% return on equity was appropriate for M&NP. New Brunswick also questioned why completion was tied to the Point Tupper Lateral as well as to the Mainline. New Brunswick pointed out that separate completion guarantees have been provided for the Saint John and Halifax Laterals and questioned why this did not apply to Point Tupper. New Brunswick submitted that the Board should not allow the guarantee fee after 30 November 1999 when the Mainline was completed. M&NP responded that the earliest date that it could have achieved financial completion was March 2000 when sufficient gas flowed from Sable Offshore Energy Incorporated (SOEI) to complete performance testing.

Views of the Board

When M&NP entered into the completion guarantee, it reasonably expected the Point Tupper Lateral to be completed at the same time as the Mainline. The Board therefore finds that M&NP acted reasonably in including this project with its Mainline financing.

While it is difficult to quantify the cost of providing a debt guarantee, the Board accepts that there is a cost to the sponsor companies. The Board is of the view that 25 basis points are a reasonable charge for guaranteeing M&NP's debt, subject to completion. Offsetting savings in bank debt rates reduce the costs to 12.5 basis points.

Decision

Pending satisfaction of the completion guarantees associated with M&NP's Mainline financing, the Board finds the payment of a guarantee fee of 25 basis points on the Mainline debt to be acceptable.

4.1.3 Cost of Interest Rate Risk Management Products

In its forecast cost of debt for the test period, M&NP included costs related to hedging interest costs under rate swap instruments and the purchase of an interest rate cap. It was M&NP's evidence that no expenditures had been made to date under the risk management program, pending release of completion guarantees which in turn are dependent on the completion of the Point Tupper Lateral. It also stated that a number of shippers would prefer that M&NP did not hedge its bank debt because the empirical evidence shows that on average floating rates have been less than fixed rates.

ECPG noted that M&NP had included $444,000 in its cost of service on account of fixed rate swaps and $615,000 for the purchase of an interest rate cap. It argued that these costs should be excluded from the cost of service because they are not being incurred in the test period.

Views of the Board

As of the date of the hearing, only three months remained in the test period. It is now less likely that M&NP will incur costs in the test period related to interest rate swap or interest rate cap instruments, and if such costs were incurred it is probable that the costs would be substantially reduced to reflect the short period of time left in the test period.

Decision

All costs relating to interest rate swap or interest rate cap instruments shall be removed from the cost of service estimates for the test period. To the extent that such costs are incurred during the remainder of the test period, M&NP may record the costs in its interest expense deferral account (see section 6.6). The Board has estimated M&NP's cost rate for debt at 7.127% after removing these costs.

4.2 Rate of Return on Rate Base

Decision

Based on the decisions contained in these Reasons for Decision, the Board has estimated a rate of return on rate base of 8.596% for M&NP for the test period. The capital structure and overall rate of return as estimated by the Board are shown in Table 4-1.

Table 4-1
Approved Deemed Average Capital Structure
and Rates of Return for the Test Period

	Amount ($000)	Capital Structure (%)	Cost Rate (%)	Cost Component (%)
Long Term Funded Debt	605.795	75	7.127	5.346
Common Equity	201.932	25	13.000	3.250
Total Capitalization	**807.727**[3]	**100**		
Rate of Return on Rate Base				**8.596**

[3] Rate Base 716.993
GPUC 90.734
807.727

Chapter 5

Operating Costs

5.1 Operating and Maintenance

As stated in section 3.1, Mainline Construction Costs, regarding *Governance and Compensation*, St. Clair is the Westcoast affiliate responsible for operating and maintaining the pipeline. According to the 20-year Operating Agreement dated 25 July 1996, M&NP is to pay St. Clair a monthly management fee consisting of:

- the actual cost of expenses (other than salary costs) paid by St. Clair on behalf of M&NP during the month in performing services, and
- 200% of an allocable portion of the actual salary cost of employees of St. Clair and its affiliates who performed services during the month.

Further, all employees who work for M&NP are employees of St. Clair. The arrangement provides that St. Clair pays for the benefit and pension expenses, including employee incentive compensation, relocation costs and other costs. The 200% charge provides for the operator to absorb all administrative and overhead costs at its Ontario offices and is not intended to include a profit component for St. Clair.

M&NP stated that it does not want to hire its own employees but prefers to continue with the Operating Agreement with St. Clair so as to have better access to qualified people already in the Westcoast organization. M&NP judged these arrangements preferable to hiring its own people because of the limited opportunities that M&NP can offer and the consequential adverse effects on the quality of people that M&NP could attract.

While M&NP confirmed that it could hire its own staff, it did not believe that it would save money by doing so. It estimated that it would incur additional training and moving costs as well as be obliged to hire more staff than would be the case with experienced employees. There is also a concern that people from the Westcoast family of companies would find little incentive in leaving their current positions, including their pension and their ability to be promoted within the larger organization.

Regarding the 200% rate, M&NP explained that its level is intended to create a break-even situation with no profit component, in that St. Clair is compensated not only for its salary costs but also the other charges that it pays for in carrying out its duties. During the hearing, however, M&NP provided no breakdown of the types of costs that are intended to be covered by the charge.

CAPP suggested that there should be an approved cost allocation methodology for shared employees, adding that TransCanada PipeLines Limited (TransCanada) and other pipelines have such a structure.

ECPG submitted that the measure of just and reasonable tolls should not be taken from inter-affiliate agreements and that regulation should be a transparent process. ECPG stated that there were no

precedents for M&NP's requested 200% rate and suggested that the maximum level should be the one used for Westcoast - 165%.

In argument, Shell did not comment directly on the 200% rate, but stated that, even though it participated in the discussions that culminated in the definitive agreements, which include the Operating Agreement, it did not sign them because they contained terms that Shell could not support.

Views of the Board

The Board is concerned by the lack of transparency in the current arrangements where expenses chargeable to M&NP are covered through a blanket overhead factor applied to relevant salary charges pursuant to the Operating Agreement. The Board is also concerned by the fact that M&NP was unable to readily provide a listing of the expenses covered by the charge.

Decision

For this test period, the Board has decided to approve the forecast operating costs associated with the overhead charge for the purposes of calculating tolls. For the next test period, however, so as to provide transparency as well as to encourage M&NP to control costs, the Board has decided that M&NP is to either hire its own employees and charge costs accordingly or compensate St. Clair for its actual costs incurred on its behalf. M&NP is to advise the Board of its decision in a timely manner.

5.2 Code of Conduct

During cross examination by CAPP, M&NP undertook to work with its Tolls and Tariff Working Group (TTWG) to try and elaborate its Code of Conduct. M&NP also submitted that its Code of Conduct, as filed, should give the Board comfort that M&NP conducts itself in the manner expected of other Group 1 pipelines under the Board's jurisdiction.

CAPP noted and thanked M&NP for its undertaking to improve its Code of Conduct and asked the Board to direct that a meaningful dialogue on this subject take place, with the resolution to come back to the Board.

Views of the Board

In view of the number of transactions that M&NP conducts with its affiliates, the Board considers it very important that a clear and comprehensive code of conduct be in place to avoid conflict of interest. The Board notes M&NP's undertaking to work with its TTWG to revise its Code of Conduct. The Board encourages all parties to carefully consider such revisions.

Chapter 6

Deferral Accounts

M&NP applied for approval of six deferral accounts related to revenue and cost of service components of its application. M&NP stated that these deferral accounts are required as they represent amounts that are not forecastable, are not within M&NP's control, and involve potential variances that could have a material impact on M&NP's overall revenues or cost of service. In this proceeding, M&NP requested approval to establish these deferral accounts, along with approval of certain methodological matters such as the appropriate carrying charges and the manner for disposing of the balances.

6.1 Billing Disputes/MN365 Demand Determinants

Certain shippers have disputed or withheld payment of M&NP's monthly demand charges. Therefore, M&NP requested the establishment of a deferral account wherein it would account for payments withheld or paid under protest during the test period. To the extent that the billing disputes from the test period are not resolved in favour of M&NP, it proposed that the test period shippers be charged these amounts through a one-time bill. Should the firm demand determinants for the test period otherwise change, M&NP proposed that this deferral account also be used to record any resulting revenue variance.

M&NP stated that the disputed billings are clearly beyond its control. It simply went into service when leave to open was received and certain shippers then refused to pay their bills. M&NP submitted that the uncertainty created by the billing disputes and their impact on M&NP's tolling clearly warrants approval of the deferral account.

ECPG argued that none of the disputes which M&NP seeks to put into a billing disputes deferral account meet the Board's established criteria for deferral accounts. ECPG stated that the matters in dispute were forecastable and they were within the control of the pipeline. Therefore, they should be part of shareholder risk.

Irving Oil Limited (Irving Oil) stated that, should the courts ultimately find that M&NP was wrong, then the effect of that should not be visited upon the tollpayers of the pipeline but on the shareholders.

Views of the Board

The Board has established three criteria for approval of deferral accounts: lack of control over the level of costs or revenues, inability to reasonably forecast the level of costs or revenues, and the materiality of the potential cost or revenue deferral account balances.

When deferral accounts are established, they are used to record variances between the forecasted amounts and the actual amounts for particular items, with scrutiny of the deferred balances at a subsequent proceeding. In the case of these billing disputes, M&NP has included the demand determinants in the calculation of its test period tolls. To the extent that the bills remain unpaid, there remains a variance between the

forecasted amount and the actual amount of revenue anticipated to be collected through tolls.

These facts, coupled with the amount in dispute, have persuaded the Board that the criteria for deferral accounts have been met and that the account should be established. Scrutiny of any amounts recorded in the deferral account, and their disposition, will be examined in a subsequent toll proceeding.

Decision

The Board approves the Billing Dispute/MN365 Demand Determinants deferral account for the test period.

6.2 Other Revenues

M&NP has not forecast interruptible or other revenues, such as overrun revenues, for the test period. Should M&NP collect any such revenues during the test period, it proposes that they be placed in a deferral account and credited to Period 1 shippers based on contracted demand determinants.

As described in section 6.7, ECPG stated that this deferral account illustrates the inequity of M&NP's proposal to calculate carrying charges on the opening monthly balance, rather than on the average monthly balance.

Views of the Board

The Board recognizes that the amount of interruptible and other revenues is difficult to forecast and not entirely within the control of M&NP. The Board finds this deferral account to be reasonable as it will benefit shippers should additional revenue be collected in the test period.

Decision

The Board approves the Other Revenues deferral account.

6.3 Legislative and Assessment Changes to Taxes

M&NP has forecast certain levels of Nova Scotia Municipal Tax, Nova Scotia Business Occupancy Tax, New Brunswick Municipal Tax, Nova Scotia Capital Tax, New Brunswick Capital Tax, Income Tax and Large Corporation Tax. M&NP noted that the level of these taxes is beyond its control and can change on very short notice. It proposed that any difference between its forecast and the actual value for these items in the test period related to changes in tax rates or assessments be captured in this deferral account and charged or credited to Period 1 shippers based on contracted demand determinants.

No intervenor commented on this deferral account.

Views of the Board

The Board recognizes that changes in tax rates and new taxes are clearly beyond M&NP's control. The Board finds the requested deferral account to be appropriate for the test period.

Decision

The Board approves the Legislative and Assessment Changes to Taxes deferral account.

6.4 Litigation, Mediation and Arbitration

M&NP may be required to defend itself in proceedings initiated by the Nova Scotia Department of Fisheries and the Regional Municipality of Cape Breton. M&NP proposed that it record any such costs incurred in a deferral account. As noted above, M&NP proposed that any balance in this account be charged to the applicable transmission accounts when each of these matters are resolved.

ECPG argued that, if the pending litigation results in a conviction, the costs of such a proceeding should be at the shareholders' risk. ECPG submitted that tollpayers should not be required to pay for a utility's misfeasance or malfeasance.

New Brunswick objected to this deferral account because, in its submission, M&NP can assess its potential liability with the assistance of legal counsel and plan and budget for it. New Brunswick stated that M&NP should bear the risk of its forecast being wrong.

M&NP argued that its legal costs are unforecastable, not totally within its control and could prove to be material. It cautioned against issuing any substantive direction or ruling on this subject prior to resolution of the issue itself, at which time there can be a full discussion in light of the facts on the matter.

Views of the Board

The Board is satisfied that the costs associated with the above-noted proceedings are not reasonably forecastable, not entirely within the control of M&NP, and have the potential to be material. The appropriateness and disposition of any amounts included in this account will be examined in a later toll proceeding.

Decision

The Board approves the Litigation, Mediation, and Arbitration deferral account for the test period.

6.5 Toll Hearing Costs

M&NP stated that it was unable to forecast its toll hearing costs because of uncertainty of the scope and the location of the hearing. M&NP included an initial hearing cost of $750,000 in its application and

requested a deferral account for any additional costs. It stated that it did not anticipate its hearing costs to be less than $750,000 but it is willing to credit shippers with the difference between actual costs and the forecast should the actual costs be less.

ECPG stated that this deferral account does not meet the Board's criteria for the establishment of deferral accounts. It submitted that there has not been any other case in which a pipeline has suggested that the toll hearing costs are not within its control and are not forecastable.

NSPD expressed some concerns with the TTWG process (see Chapter 9) and asked the Board to reflect carefully before considering approval of M&NP's request for a deferral account for hearing costs.

Views of the Board

The Board acknowledges that this was M&NP's first toll hearing and that the scope and location of the hearing were not known at the time it filed its application. On this basis, the Board is prepared to grant this deferral account for the test period. With the experience gained in this proceeding, the Board expects M&NP to be able to forecast its hearing costs in the future and does not expect this deferral account to be necessary in the next test period. Also, the Board agrees that this account should operate to capture variances either over or under the $750,000 estimate.

Decision

The Board approves the Toll Hearing Costs deferral account for the test period.

6.6 Interest Expense

M&NP currently has 100% of the debt outstanding under its Term Bank Financing at floating interest rates. M&NP stated that there is a high degree of uncertainty around the interest cost associated with its debt due to the high percentage of floating rate debt outstanding, interest rate volatility in the financial markets, and the timing and nature of any interest rate hedging activities. Therefore, M&NP proposed that it record the difference between projected and actual costs in a deferral account for disposition to test period shippers.

New Brunswick objected to the creation of this deferral account. It submitted that M&NP has ample protection against interest rate changes through fixed rate swap and interest rate caps. New Brunswick noted that M&NP has yet to use these tools.

Views of the Board

As noted in section 4.1.3, M&NP will not incur any expenditures under its interest rate risk management devices until the completion guarantees on its debt financing have been released. Given that 100% of its outstanding debt is at floating interest rates, the Board agrees that M&NP is subject to uncertainty with respect to its debt financing costs at this time. Therefore, the Board finds that the requested deferral account is appropriate.

Decision

The Board approves the Interest Expense deferral account for the test period.

6.7 Disposition of Account Balances and Carrying Charges

M&NP stated that, should its requested deferral accounts be approved, it would make a subsequent application for disposition of the test period balances to the test period shippers. The only exception is for the Litigation, Mediation and Arbitration deferral account. M&NP explained that, since any amounts recorded in this account would relate to the construction and development of the M&NP Mainline, the balance should be charged to the applicable transmission accounts when each of the matters are finally resolved.

M&NP proposed that all balances accrue carrying charges at its approved rate of return on rate base. It initially proposed to have carrying charges apply to the average monthly balances but later amended its application to have the carrying charges apply to the opening monthly balances of the deferral accounts. M&NP explained that its amended proposed methodology is consistent with the other calculations in the application and it is also consistent with how Westcoast calculates carrying charges for deferral accounts.

With respect to the deferral account for other discretionary revenues, ECPG argued that M&NP's proposal to calculate carrying charges on the opening monthly balance, rather than on the average monthly balance, was inequitable. That is so, ECPG submitted, because discretionary revenues can only increase. ECPG submitted that the benefit of those revenues should go to the tollpayers, not to the pipeline.

Views of the Board

The Board finds M&NP's proposal to dispose of the test period balances to the test period shippers, except for the Litigation, Mediation and Arbitration deferral account, to be reasonable.

With respect to carrying charges, the Board finds the rate of return on rate base to be the appropriate rate for operating deferral account balances. However, the Board shares ECPG's concern that calculating carrying charges on the opening monthly balance, particularly on accounts that can only increase such as the Other Revenue account, is inequitable. Accordingly, the Board is of the view that carrying charges should be calculated on the average of the opening and closing monthly balances for all deferral accounts.

Decision

The Board approves M&NP's proposal to dispose of test period balances in deferral accounts to the test period shippers. The Board has also decided that carrying charges shall be calculated on the average of the opening and closing monthly balances at the approved rate of return on rate base.

Chapter 7

Tariff Matters

7.1 Termination/Extension of Long-term Service Agreements

Section 4.4 of the General Terms and Conditions (GT&C) of M&NP's Tariff provides for M&NP or a customer to give a notice of termination of a long-term firm service agreement at any time during a contract term up to two years before the expiry of a contract. Within 30 days of giving such notice, the capacity shall be posted on M&NP's electronic communications system for bids and can remain open for bids until 60 days from the expiry of the contract. Capacity will be awarded to the bid with the longest term, subject to the current shipper having a right to match the successful bid. However, the current shipper cannot be required to contract for more than five years.

Shell argued that allowing the pipeline to issue a notice of termination from day one of a contract, and allowing the bidding period to remain open until 60 days before the end of the contract, was unreasonable. However, the greater thrust of Shell's argument was its opposition to the basic concept of having contract extension rights on this pipeline determined by a bidding mechanism. Shell asserted that the use of a bidding process for capacity is intended to force shippers to contract for longer terms. It took exception to M&NP's assertion that shippers who value service the most will contract for the longest term and argued that in a tight capacity market a shipper might be forced to extend its contract for a longer term than it requires. Shell believes that the term of a contract renewal should be based on a shipper's requirements and suggested that, upon giving notice, shippers should have the right to renew their existing contracts for a minimum term of one year.

Shell pointed out that because M&NP's tolls are fixed by the Board, it is not possible to compete for service on the basis of price with the result that the value a customer places on service can only be measured by the term on a contract. It pointed to prior decisions of the Board with respect to TransCanada which supported the concept that contract-renewal policies should be designed to provide shippers with flexibility. Shell noted that those decisions supported a one-year renewal period upon six months notice. It was Shell's position that a bidding process increases the value of contracts to the pipeline at the expense of shipper flexibility. An additional concern of Shell's was the fact that separate bidding processes for M&NP and the connecting pipeline in the United States could create problems for shippers. In this regard, M&NP noted that similar problems exist for all export pipelines and testified that it would be working to provide seamless service.

CAPP, while offering no specific recommendations, suggested that the Board should take into account the following basic factors: provisions for the renewal of capacity should be fair, they should be workable, and they should strike a reasonable balance of economic interest.

It was M&NP's position that the interests of the shipper in having flexibility must be balanced against the pipeline's interest in allocating capacity appropriately. M&NP pointed out that under its tariff the maximum period for which a shipper would have to extend its term would be five years, and possibly less if competing bids for the capacity are for shorter terms. It expressed the view that the traditional one

year renewal provisions found in certain pipeline tariffs are causing problems for existing pipelines, noting that TransCanada has sought to make changes to the renewal provisions of its tariff. It also argued that longer contracts provide for toll stability and the ability to reduce tolls.

M&NP noted that, notwithstanding the fact that parties had ample notice that this issue was to be reviewed in this proceeding, only Shell had pursued it. It argued that the renewal policy should not be changed unless there is a specific, substantive alternative available, which can be determined to be superior.

Views of the Board

As a new pipeline, M&NP has required long-term contracts to underpin its construction and financing. It was for this reason that M&NP entered into backstop agreements with Mobil Oil Canada Properties and Mobil Canada Properties Ltd. for 440,000 MMBtu/d of capacity. The Board is uncertain how any change in the contract renewal provisions of the tariff might impact the liabilities under these backstop agreements. While Shell has expressed its opposition to a bidding process, it has not demonstrated how it would be specifically disadvantaged. The Board accepts that the use of a bidding process may cause shippers to commit to longer contracts than might otherwise be the case; however, this situation is only likely to occur if there is no excess capacity on the pipeline. The requirement for a five-year renewal period is not unique to M&NP. The tariff of Foothills Pipe Lines Ltd. requires its shippers to extend their contracts to maintain a term of at least five years, and provides for a bidding process for available capacity.

Shell is asking the Board to require M&NP to accept a minimum renewal term of one year. This would be a significant change from the current tariff provision. No other parties commented on this issue, either in support of, or in opposition to Shell's proposition. The Board attributes this lack of interest to the fact that all existing firm service contracts on the pipeline are long term.

The Board is concerned with the provisions of the renewal policy relating to the timing of a notice of termination and the length of time capacity can remain open to bids. However, the Board is of the view that there was not adequate examination on this issue to grant Shell's request. These are matters that can be reviewed by the TTWG.

Decision

In view of the unique circumstances of M&NP as a new pipeline, the Board was not persuaded that the contract renewal provisions of its tariff are inappropriate. The Board would be prepared to review this issue in a future proceeding if a party could demonstrate that it is being unreasonably disadvantaged by the contract renewal provisions of M&NP's tariff.

7.2 Fuel Retainage True-up Mechanism

As per Article 20 of the GT&C of M&NP's Tariff, shippers must provide gas required by M&NP to transport their gas on its system. This is referred to in the Tariff as the Fuel Retainage Quantity and has been set for the test period as 0.5%. The tariff requires the Fuel Retainage percentage to be set twice per year in April and November based on operating experience. Variances are to be adjusted to the following period. In this proceeding Irving Oil suggested that, for this initial test period only, any variance should be directly charged or credited to test period shippers.

Irving Oil argued that significant additional firm service volumes are expected to commence immediately after the test period, and non-test period shippers should not be required to provide additional quantities of Fuel Retainage gas in order to balance test period operations. Irving Oil noted that adjusting any variance to test period shippers would be consistent with M&NP's proposal for disposing of test period deferral account variances. ECPG argued in support of Irving Oil's proposal.

M&NP stated that its proposal to adjust Fuel Retainage in the following test period was based on the requirements of the tariff. Absent a specific direction from the Board, M&NP is bound to adhere to the provisions of the tariff. It was M&NP's evidence that if the test period shippers were not opposed M&NP would not object to a one-time adjustment of the Fuel Retainage account as proposed by Irving Oil. No party argued against Irving Oil's suggestion.

Decision

M&NP is directed to adjust its fuel retainage account at the end of this test period and make the appropriate adjustment in kind to the test period shippers. Unless the Board otherwise directs, adjustments in future test periods should be made in accordance with the provisions of the tariff.

Chapter 8

Provincial Discounts

The Joint Position on Tolling and Laterals is an agreement among the Province of Nova Scotia, the Province of New Brunswick, the Sable Offshore Energy Project (now SOEI) and M&NP, dated 19 June 1997 and adopted by the Board in its GH-6-96 Decision. In the Joint Position, M&NP agreed to discount firm service tolls to delivery points located in Nova Scotia by ten percent for an initial period of eight years and four percent for each of the next succeeding two years. M&NP further agreed to discount firm service tolls to delivery points in New Brunswick by four percent for the initial three years. Parties raised issues related to the administration of the discounts.

8.1 Commencement Date of Discounts

The issue of the commencement date for the provincial discounts was originally raised by the NSPD in its intervention. However, the issue was not addressed in its evidence. The evidence confirmed that at the time the Joint Position was signed it was anticipated that deliveries would occur at Halifax before they occurred on the Point Tupper Lateral. M&NP confirmed its intention that the discount period in Nova Scotia would commence with the first delivery of gas in the province and that if the first delivery was to take place on the Point Tupper Lateral, the discount period would commence at that time. No party advanced a position on this issue in argument.

Decision

The Board confirms that the provincial discount periods will commence with the first deliveries of gas in each province.

8.2 Applicability to Delivery Points

In its initial application, M&NP indicated that provincial discounts would only be applicable at primary delivery points under firm service contracts and that diversions to secondary delivery points would not be eligible for the discounts. In support of this interpretation of the discount provisions of the Joint Position, M&NP argued that service to secondary deliveries points is not true firm service in that such service is on a best-efforts basis and can be curtailed or interrupted in order to meet primary delivery point obligations.

In response to M&NP's position, the Province of New Brunswick and the Province of Nova Scotia, as represented by the NSPD, filed joint evidence providing the testimony of three witnesses who were directly involved with the negotiation of the Joint Position. It was their evidence that a distinction between primary and secondary delivery points was never made or discussed during these negotiations and it was their understanding that the discounts would apply to all deliveries under firm service contracts within each province. Irving Oil also presented evidence to the effect that the Joint Position did not say anything about primary or secondary delivery points.

During the hearing, in response to what M&NP believed to be an apparent misunderstanding among the parties of the intent of the Joint Position, the President of M&NP filed an opening statement altering M&NP's original position and offering instead what he called a compromise position. M&NP proposed that the provincial discount would apply to all firm service contracts based on the contract demand and primary delivery point. It was M&NP's position that the discount would be payable based on the primary delivery point even if the gas was diverted to a secondary delivery point or exported. It submitted that this approach recognizes the importance of the firm service contract in supporting the economic feasibility of lateral construction and enhances the use of facilities, while providing shippers with the flexibility to re-market gas at the full discount when the primary market used to justify the lateral does not require the gas.

In response to the compromise position proposed by M&NP, New Brunswick filed supplementary evidence proposing that all firm deliveries in Nova Scotia, at primary and secondary delivery points, should receive the Nova Scotia discount, and all firm deliveries in New Brunswick, at primary and secondary delivery points, should receive the New Brunswick discount. The discount and discount period would apply to each shipper based on the province in which the gas was delivered rather than the location of the primary delivery point. This position was widely supported by intervenors.

New Brunswick argued that under its proposal all deliveries in either New Brunswick or Nova Scotia would receive the same discount, based on the province of delivery. Diversions from Nova Scotia to New Brunswick or vice versa, would have no advantage or disadvantage over the other. CAPP noted that this proposal links the discount to the location where the gas is used.

Many parties commented on the fact that the discounts were provided in the Joint Position to help develop the Canadian market. Considerable discussion centred on which proposal best supported this goal. M&NP advanced the view that the cost incentive of applying the provincial discounts to the full contracted demand, as well as the planning and operational certainty that will arise from that, will encourage parties to anchor laterals necessary for market development in the region. Sempra and NSPD questioned how providing a discount for exports could be a help in building local markets.

M&NP's compromise proposal drew criticism from most parties including CAPP, ECPG, New Brunswick, NSPD, Enbridge Gas New Brunswick Inc., Sempra Atlantic Gas Company and Irving Oil. These parties argued that it was not the intention of the parties to the Joint Position to provide the discount on export volumes. They also maintained that M&NP's compromise position would not create a level playing field and could lead to market distortions and arbitrage opportunities because gas under a Nova Scotia contract, entitled to a 10% discount, would have a price advantage over gas delivered under a New Brunswick contract with a 4% discount.

The M&NP proposal also raised concerns about toll discrimination. ECPG noted that it would create the potential for three different tolls in each province and at the U.S. border. It was M&NP's position that it prices firm service to the primary delivery point. The fact that different tolls might result for firm versus best efforts service at the same delivery point is neither surprising nor objectionable. M&NP referred to many examples in the tariffs of other pipelines regulated by the Board where different tolls are charged for deliveries to the same delivery point. As an example, it noted that volumes destined for export on TransCanada can attract a different toll than volumes for delivery in a domestic market due to the use of

zone pricing for domestic volumes. Similarly, TransCanada's bidding regime for interruptible tolls can produce the same results.

M&NP suggested that the New Brunswick proposal would be difficult to implement and operate and would impose additional costs. ECPG argued that it had the same level of complexity as the original M&NP proposal and should be no more difficult to administer.

Views of the Board

The Joint Position clearly states that M&NP agreed to discount firm service tolls to delivery points in Nova Scotia and New Brunswick. No distinction is made in the Joint Position between primary and secondary delivery points, and the Board accepts the evidence provided that such a distinction was not discussed during the negotiations leading to the agreement and was not contemplated by most parties to the agreement. In its opening statement, M&NP agreed that there had been some misunderstanding on this point.

It is clear from a plain reading of the Joint Position that firm service tolls to delivery points located in Nova Scotia and delivery points located in New Brunswick would receive discounts. The reference to delivery points implies to the Board that it was the intention of the parties that volumes would need to be delivered to be eligible for the discounts. It is therefore reasonable to conclude that a discount based on contract demand alone was not anticipated. The Board also notes that the Joint Position does not make any reference to discounts applying to deliveries at the international border.

Decision

The Board finds that the interpretation made by New Brunswick is the most consistent with the wording of the Joint Position; namely, that all firm deliveries in Nova Scotia, to either primary or secondary delivery points, should receive the Nova Scotia discount, and all firm deliveries in New Brunswick, to either primary or secondary delivery points, should receive the New Brunswick discount. No discounts would apply to export volumes.

Chapter 9

Tolls and Tariff Working Group

In its argument, NSPD commented on the TTWG process; specifically, the fact that the TTWG did not resolve a single issue related to this proceeding and the high number of information requests and days of hearing time to obtain basic information on a wide range of issues. In view of this, NSPD urged the Board to make it clear to M&NP that the Board expects M&NP to take the necessary steps to ensure a fully functioning and productive TTWG process.

M&NP stated that it does not believe that the inability of the TTWG to resolve a single issue should be blamed on M&NP alone. Nor did M&NP believe that the high number of information requests is indicative that M&NP did not do everything within its power to resolve tolls and tariff issues at the TTWG itself.

M&NP stated that it is committed to the process and is willing to work to resolve issues within the TTWG. M&NP opined that the difficulties can be attributable to the diverse group at the TTWG with differing views and, most importantly, the desires of the parties to air the issues of the first tolls case thoroughly at a public forum. M&NP remains hopeful that the group can function successfully in the future.

Views of the Board

The Board continues to support the task force or TTWG process as an efficient means of allowing pipelines and parties to resolve issues outside of a Board process, thereby saving hearing time and costs to all parties. However, the Board is reluctant to intervene in the manner in which the TTWG conducts its business and believes that issues respecting the operation of the TTWG process are best left to the parties to work out. The Board is always available to consider and decide on issues should any party feel that it is not receiving equitable consideration of an issue at the TTWG.

Chapter 10

Interim and Final Tolls

By Order TGI-3-99 dated 14 October 1999, the Board approved tolls that M&NP may charge on an interim basis effective 1 November 1999.

The Board is of the view that final tolls for the test period should be uniform throughout the test period. M&NP will be required to refund to or, where applicable, recover from its customers the difference between the tolls resulting from these Reasons for Decision and those approved on an interim basis by Order TGI-3-99, together with carrying charges at the approved rate of return on rate base for the test period.

In these Reasons for Decision, the Board has estimated the impact of its decisions on M&NP's test period revenue requirement, rate base and tolls on the basis of information available to it in this proceeding. The Board has not included a final approved rate base, rate of return on rate base, revenue requirement or tolls for the test period.

Accordingly, M&NP is required to file for Board approval new tolls, together with supporting schedules, reflecting the Board's decisions in these Reasons for Decision. These tolls and supporting schedules are to be filed with the Board forthwith and served on interested parties to this proceeding. M&NP's filing should include detailed explanations and, where necessary, tables or working papers to satisfy the Board that the new tolls reflect its decisions.

Decision

The Board intends to approve final tolls which are uniform throughout the test period. M&NP is directed to refund to its customers or, where applicable, recover from its customers, the difference between the tolls resulting from these Reasons for Decision and those approved on an interim basis by Order TGI-3-99, together with carrying charges at the rate of return on rate base approved for the test period.

The Board directs M&NP to file with the Board forthwith, and serve on interested parties to this proceeding, final tolls for the test period reflecting its decisions on matters considered in the RH-1-2000 proceeding.

Chapter 11

Legal Issues

11.1 Burden of Proof

Some parties raised a question with respect to the burden of proof that lies upon the Applicant to demonstrate its case. The Board's views on this matter are as follows.

In Westcoast Energy Inc., Reasons for Decision, RH-1-92, August 1992, the Board, based on the facts of that case, offered its reasoning on the burden of proof. This reasoning can still be applied today. The pertinent passage is as follows, starting at page 3 of that decision:

> "The Board has not altered its position with respect to the allocation of the burden of proof that was enunciated in the GH-2-87 Reasons for Decision. While the issue before the Board in this hearing is not the same issue that was before the Board in GH-2-87, nevertheless the principle remains applicable.
>
> The overall concept of the burden of proof has many components. In GH-2-87, the reference to the burden of proof was in the context of the applicant's overall or ultimate burden of proof which the applicant must discharge at the close of the hearing in order to obtain the relief that was requested in its application. The process by which the applicant undertakes to discharge its ultimate burden of proof begins with the initial filing of its application in which the applicant is under an obligation to present to the Board an application containing sufficient evidence amounting to a *prima facie* case in support of the relief requested. This evidence is augmented by responses to information requests, written evidence and cross-examination. Depending upon the particular strengths and weaknesses of the applicant's *prima facie* case, the onus of proof may shift to the intervenors during the course of the hearing to refute the applicant's case. Notwithstanding this perception of a shifting onus of proof, the ultimate burden of proof, or burden of persuasion as it is often called, always remains with the applicant. The applicant must satisfy the Board, on the balance of probabilities, that the relief sought in its application should be granted.
>
> In discharging the initial burden of presenting a *prima facie* case, it is for the applicant to determine the extent and validity of the evidence that it chooses to file. Whether or not this evidence is sufficient to discharge the applicant's ultimate burden of proof is a matter to be determined in the particular circumstances of each case. Suffice it to say that intervenors are given an opportunity to cross-examine and to present their own evidence in opposition to the applicant. They need not do so as it is for each intervenor to determine the extent to which the onus of proof has shifted from the applicant. Ultimately, it is for the Board to determine, on the totality of the evidence which is before it, whether the applicant has discharged its burden of proof."

The Board does not propose to alter its position with respect to the allocation of the burden of proof, as the principle remains the same, and is applicable to this case.

In this case, M&NP has the responsibility of proving on a balance of probabilities that it should obtain the relief that it is seeking. In the process, M&NP has to present enough evidence to sustain a *prima facie* case following all cross-examination, and redirect, if any. Then, the presentation of the applicant's evidentiary case is concluded. At this point, the evidentiary burden may shift to the intervenors to refute M&NP's case with their own direct evidence.

Whether an intervenor chooses to file direct evidence to support a view is a tactical decision which the intervenor alone must make. In this respect, the Board does not direct parties on how to present their case. However, in cases where an applicant's case is particularly strong, the decision not to adduce direct evidence is made at the intervenor's risk in that lesser weight may be attributed to the contentions of that intervenor than would have otherwise been the case if that intervenor had offered direct evidence, which the applicant could have tested. Ultimately, there is no rule dictating when an intervenor should adduce direct evidence. An intervenor, or the applicant for that matter, must advance a position that is supported by the factual record. The Board, in reaching its decision, will place the appropriate weight on all of the evidence that was adduced before it on the record.

11.2 RH-1-99 Practice Direction and Where Evidence May Come From

Some parties raised questions with respect to a ruling made by the Board in its RH-1-99 Decision and whether intervenors had to produce direct evidence to substantiate their case. The RH-1-99 ruling in question can be found at page 28 of Reasons for Decision, TransCanada PipeLines Limited, RH-1-99, April 2000. It reads:

> "The Board must have a complete factual record, including the results of cross-examination, in order to make appropriate findings of fact and decisions.
>
> As a matter of practice, the Board therefore expects to hear alternative proposals and new approaches offered by parties through evidence, and subsequent argument based on that evidence. Parties are expected to advance substantive positions by way of fact and argument, and not argument alone."

The Board is of the view that facts can be elicited by direct evidence but can also be elicited through cross-examination or by other means without having to produce direct evidence.

When conducting cross-examination, the Board will allow questions soliciting facts from a witness who has personal knowledge of those facts. Of course, counsel can always object to a question put to his/her witness on one of the established grounds, such as relevancy, privilege or confidentiality.

Other means to establish facts include the filing of the application and its supporting materials, the filing of written information requests, and the responses thereto, etc. This, combined with the facts elicited through cross-examination, redirect, direct evidence from intervenors, and reply evidence, if any is filed, makes up the entire record, which the Board will consider in reaching its decision, attributing the proper weight to the various elements constituting the record in each individual case.

This view is consistent with the Board's ruling in RH-1-99 in that positions must be supported by facts and argument, and not argument alone, which does not imply that an intervenor must produce direct evidence to support its position. Again, and as stated earlier in these reasons when discussing the burden of proof in section 11.1, an intervenor does not have to adduce direct evidence. Whether an intervenor chooses to do so is a tactical decision which that intervenor must make in the conduct of its case.

11.3 Use of Past Board Decisions

Some parties raised an issue with respect to the use of past Board decisions as precedents. The Boards views are as follows.

As an administrative tribunal, the Board strives to achieve continuity, consistency and a degree of predictability. If a principle from a past decision can be applied to a case before the Board, based on the facts of the latter case, then the Board may choose to rely on that principle in deciding the case before it. In doing so, the Board would not decide the case before it solely on the basis of the principles contained in its earlier decisions. That would inappropriately confine the Board's exercise of its statutory discretion. The Board decides each case by conducting a proper proceeding, which may include an oral hearing (as in this case), by giving appropriate weight to all of the evidence forming part of the record, and by considering all matters that it is called upon to determine. Each case is and must be determined on its own merits.

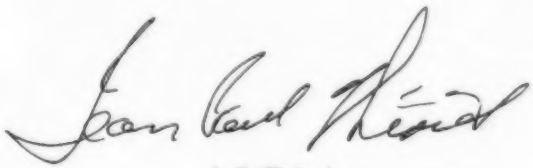
As well, the Board is of the view that a strict adherence to past decisions could constrain its ability to adapt to new situations, or changes in policy in order to fulfil its mandate.

Consequently, the Board is of the view that in deciding specific cases the Board is not strictly bound by precedents, or the principle of *stare decisis*. However, the Board may, in specific cases, decide to consider and apply principles articulated in its earlier decisions.

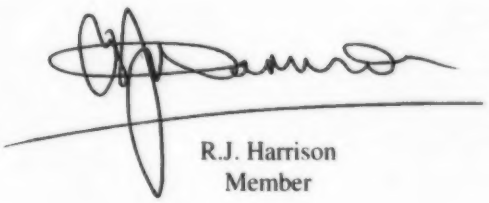
Chapter 12

Disposition

The foregoing chapters, together with Order TG-5-2000, constitute our Decisions and Reasons for Decision on matters considered in the RH-1-2000 proceeding.



J.-P. Théorêt
Presiding Member



R.J. Harrison
Member

C.L. Dybwad
Member

Calgary, Alberta
August 2000

Appendix I

Order TG-5-2000

IN THE MATTER OF the National Energy Board Act (the Act) and the regulations made thereunder; and

IN THE MATTER OF an application by Maritimes and Northeast Pipeline Management Ltd. (M&NP) dated 26 February 2000, as amended, for approval of final tolls effective 1 December 1999 pursuant to subsection 19(2) and Part IV of the Act and filed with the National Energy Board (the Board) under File 4200-M124-1.

BEFORE the Board on 25 August 2000.

WHEREAS M&NP, by application dated 26 February 2000, as amended, applied to the Board for an order or orders under subsection 19(2) and Part IV of the Act fixing just and reasonable tolls that M&NP may charge effective 1 December 1999 until 30 September 2000 for transportation that it provides;

AND WHEREAS the Board issued Order TGI-3-99 which authorized M&NP to charge, on an interim basis effective 1 November 1999, tolls for service;

AND WHEREAS the Board held a public hearing pursuant to Hearing Order RH-1-2000 in Halifax, Nova Scotia during which time the Board heard the evidence and arguments presented by M&NP and all interested parties;

AND WHEREAS the Board's decisions on M&NP's application are set out in its RH-1-2000 Reasons for Decision dated August 2000 and in this Order.

IT IS ORDERED THAT:

1. M&NP shall calculate new tolls in accordance with the decisions set out in the RH-1-2000 Reasons for Decision and with this Order and shall forthwith file with the Board for approval, and serve on all intervenors to the RH-1-2000 proceeding, the new tolls, together with supporting schedules;

2. M&NP shall, for accounting, tollmaking and tariff purposes, implement procedures to conform with the Board's decisions outlined in the RH-1-2000 Reasons for Decision;

3. Order TGI-3-99, which authorized tolls that M&NP may charge on an interim basis, is revoked and the tolls that have been authorized thereunder are disallowed at the end of the day on 30 September 2000;

4. M&NP shall charge on a final basis, for service commencing 1 December 1999, tolls authorized by paragraph 1 of this Order;

5. M&NP is directed to refund that part of the tolls charged by M&NP under Order TGI-3-99 which is in excess of the tolls determined by the Board to be just and reasonable in this Order or, where applicable, to recover the amount by which the tolls contemplated in this Order exceed the tolls charged by M&NP under Order TGI-3-99, together with carrying charges on the amount so refunded or recovered at the rate of return on rate base approved in the RH-1-2000 Reasons for Decision;

6. The refund or recovery authorized by this Order shall be effected without delay;

7. M&NP shall file with the Board forthwith, and serve on all interested parties to the RH-1-2000 proceeding, tariff amendments, including tolls, conforming with the decisions set out in the RH-1-2000 Reasons for Decision dated August 2000 and with this Order; and

8. Those provisions of M&NP's tolls and tariffs, or any portion thereof, that are contrary to any provision of the Act, to the Board's RH-1-2000 Reasons for Decision, or to any Order of the Board including this Order, are hereby disallowed.

NATIONAL ENERGY BOARD

Michel L. Mantha
Secretary

Appendix II

Joint Position on Tolling and Laterals

M&NP is a signatory to the Joint Position on Tolling and Laterals dated 19 June 1997 along with the Sable Offshore Energy Project and the Provinces of Nova Scotia and New Brunswick. The provision related to Tolls reads as follows:

"Subject to the qualifications outlined below, the signatories confirm their agreement with M&NP's applied-for postage stamp tolling structure as presented to the Joint Review Panel. In order to provide both Nova Scotia and New Brunswick with lower rates to help develop the Canadian market, M&NP agrees to discount firm service tolls to delivery points located in Nova Scotia by ten (10%) percent for the initial eight (8) years and four (4%) percent for each of the next succeeding two (2) years. M&NP further agrees to discount firm service tolls to delivery points located in New Brunswick by four (4%) percent for the initial three (3) years. It is agreed that M&NP will reflect any revenue deficiency associated with the discounts in an adjustment to its depreciation."

Appendix III

List of Issues

The Board has identified, but does not limit itself to, the following issues for discussion during this proceeding:

1. The appropriate rate base for the test year, including matters related to items proposed for inclusion, variations between forecast and actual costs, AFUDC calculations, and capitalization of engineering and operating costs.

2. The appropriate throughput for the test year, including matters related to demand determinants and cost allocation.

3. The appropriate revenue requirement for the test year, including matters related to operating and maintenance expenses, the calculation of debt and equity returns, income taxes, municipal and other taxes, and depreciation expense.

4. The appropriateness of the requested deferral accounts, including the proposed disposition of such accounts.

5. Matters related to the administration of the provincial discounts in Nova Scotia and New Brunswick, including commencement dates and applicable delivery points.

6. The provisions of section 4.4 of General Terms and Conditions pertaining to the rights to terminate and extend long-term transportation agreements.